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# Federal-Provincial Study on the Cost of Government and Expenditure Management

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## Summary

May 1992



Department of Finance  
Canada

Ministère des Finances  
Canada



## PREFACE

This document presents a summary of research undertaken by a joint working group of federal and provincial officials, at the request of Ministers of Finance and Treasurers. A detailed account of this research is being published separately. In this summary, the features of individual provinces and territories are not usually identified. Readers interested in this aspect of the research are referred to the detailed document.

The work was essentially fact-finding in nature and designed to shed light on a number of key issues in the area of government spending. As such, the analysis and findings contained herein should be seen as those of the working group and should not be construed as representing the views and/or position of governments or Ministers of Finance and Treasurers. And, in fact, it should not be assumed that there was unanimous agreement of the working group in respect of every finding and conclusion in the report.

The main data sources, from Statistics Canada, are the Financial Management System (FMS) and the Canadian Income and Expenditure Accounts (CIEA), or National Accounts. The FMS is a standardized set of public accounts providing data according to a consistent definition of spending functions across jurisdictions. The CIEA also provide consistent data across jurisdictions. A major advantage of the FMS data is the degree of detail provided on spending functions while a major advantage of the CIEA data is the length of the historical time series.



## CAVEATS

- Reflecting the Ministers and Treasurers' specific concerns, the study deals only with spending. No attempt is made to analyze the evolution of revenues or to draw conclusions on budget balances.
- Inter-provincial/territorial comparisons may present problems. Reflecting institutional differences, the content of a spending category may differ across provinces. A case in point is the social services category which encompasses numerous programs targeted at different clienteles and operating under different parameters, even if these programs are aggregated under the same general category. Furthermore, the structure of a spending category in a jurisdiction may evolve over time.
- The focus of the analysis is often on ratios of spending to GDP. This allows for more meaningful comparisons across jurisdictions as it takes into consideration the capacity of a jurisdiction to finance a given level of spending. As such, spending-to-GDP ratios reflect the relative evolution of the two components. An increase in a ratio may reflect stable spending combined with a decline in the GDP. In some provinces, the evolution of nominal GDP is strongly influenced by the volatility of commodity prices. Also, the fact that the economic activity is not always synchronized between the jurisdictions may impact on inter-provincial comparisons of spending ratios.
- The study focuses on the major spending pressures on governments in Canada. Although some efforts went into identifying provincial differences from national patterns, this aspect of the study was not carried to its fullest extent.
- Finally, it is crucial to emphasize that the mechanical extrapolations of government spending presented in the study are essentially illustrative and do not represent forecasts of any spending components. They are only mechanical extrapolations reflecting assumptions about the main components of various spending categories.

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## 1.0 Introduction

In January 1991, federal and provincial Finance Ministers and Treasurers asked their officials to carry out a joint study focusing on the growth of government spending.

Three questions addressed by the study are:

- What have been the major pressures on government spending since the mid-1970s?
- What are the likely pressures on spending in the 1990s and beyond?
- What action has been taken by governments inside and outside Canada to counter spending pressures?

## 2.0 Historical Pressures on Government Spending

### 2.1 Summary of Trends in Spending between 1975 and 1989

Charts 1 and 2 illustrate trends in the major federal and provincial-local-hospital (PLH) spending aggregates on a National Accounts, calendar-year basis. Aggregate PLH trends may not reflect developments in each province. The principal messages are that:

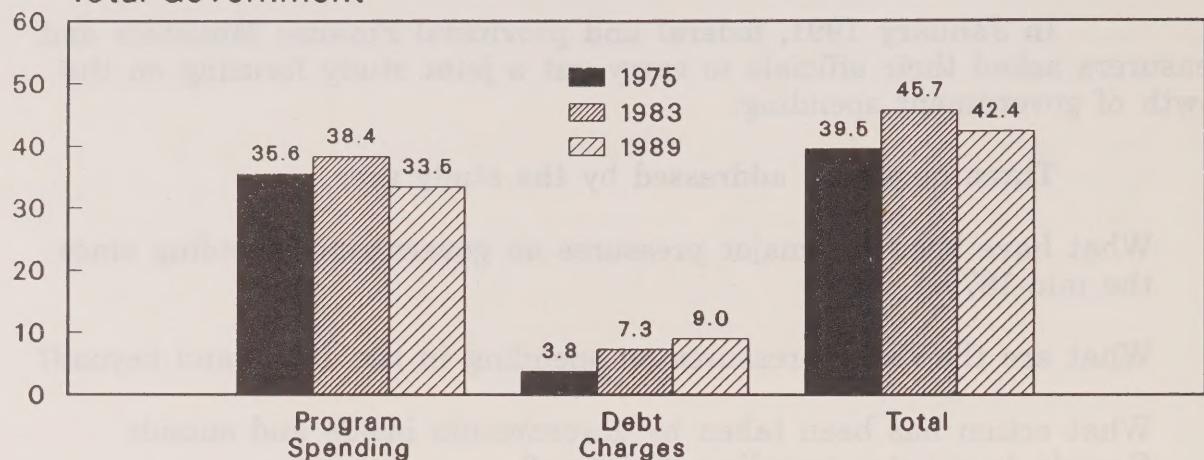
- The GDP share of total government spending increased modestly from 39.5 per cent to 42.4 per cent.
  - But within this period, spending increased rapidly to peak at 45.7 per cent in 1983 and then fell.
  - Both levels of government shared in this rise and fall.
- Within total spending, there was a marked shift in the balance between program spending and debt charges.
  - Program spending fell slightly overall, rising from 35.6 per cent of GDP to 38.4 per cent in the peak year of 1983 and then falling to 33.5 per cent.

Chart 1

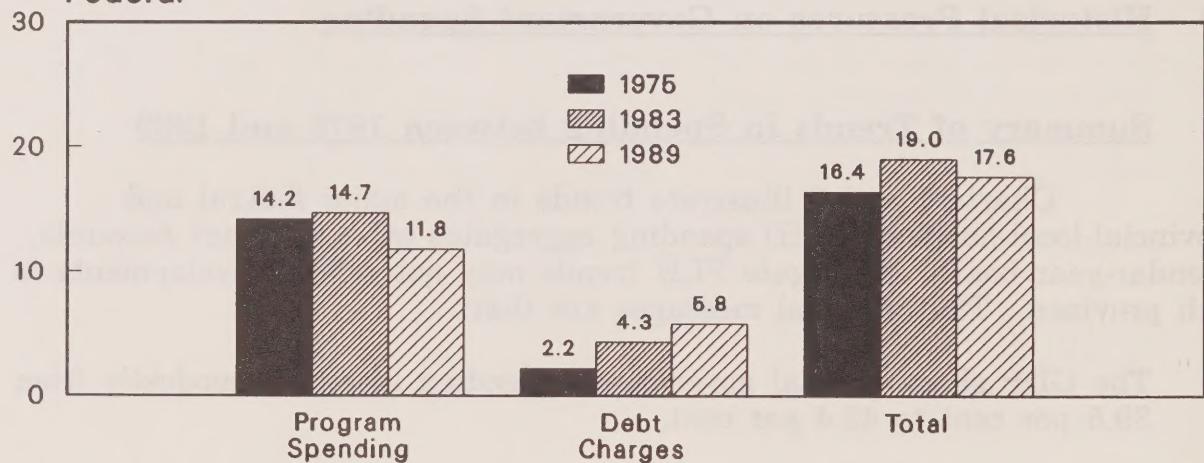
## The Structure of Direct Government Spending

National Accounts Basis -- per cent of GDP

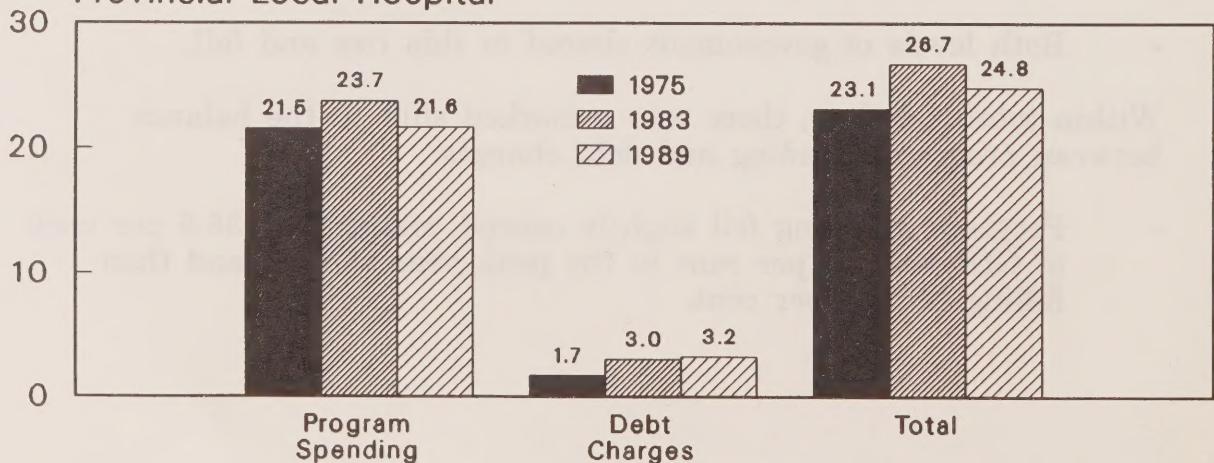
### Total Government



### Federal

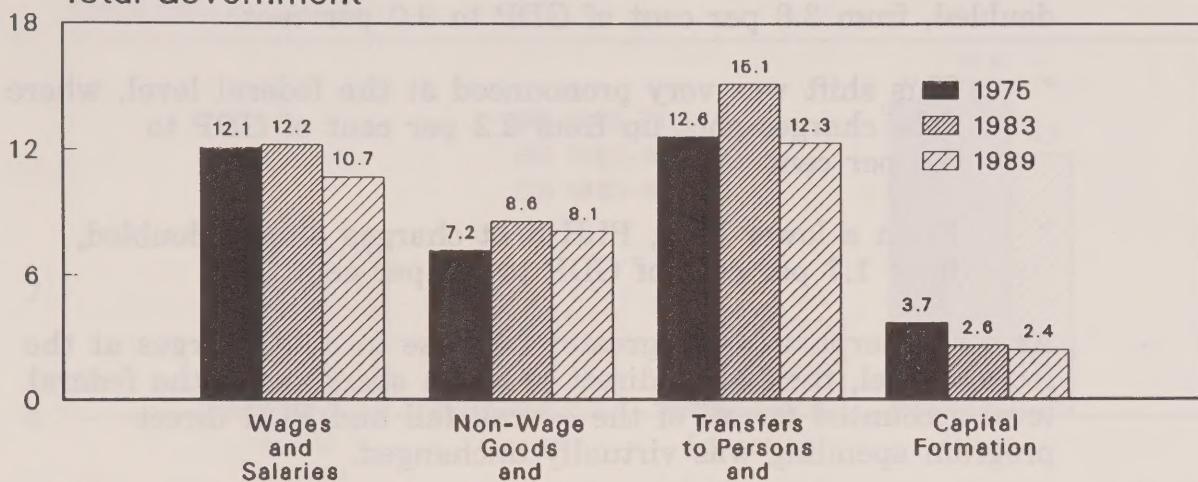


### Provincial-Local-Hospital

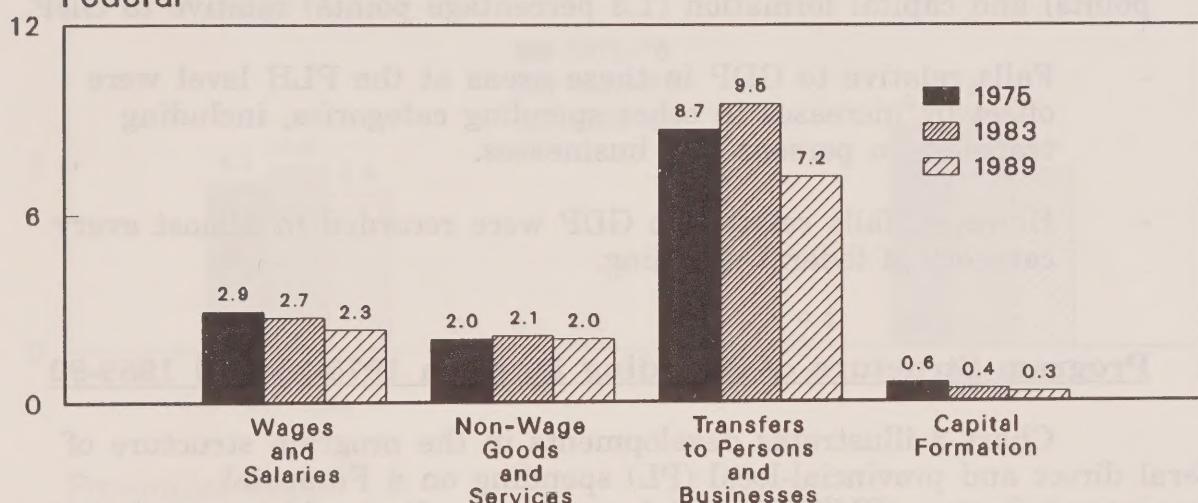
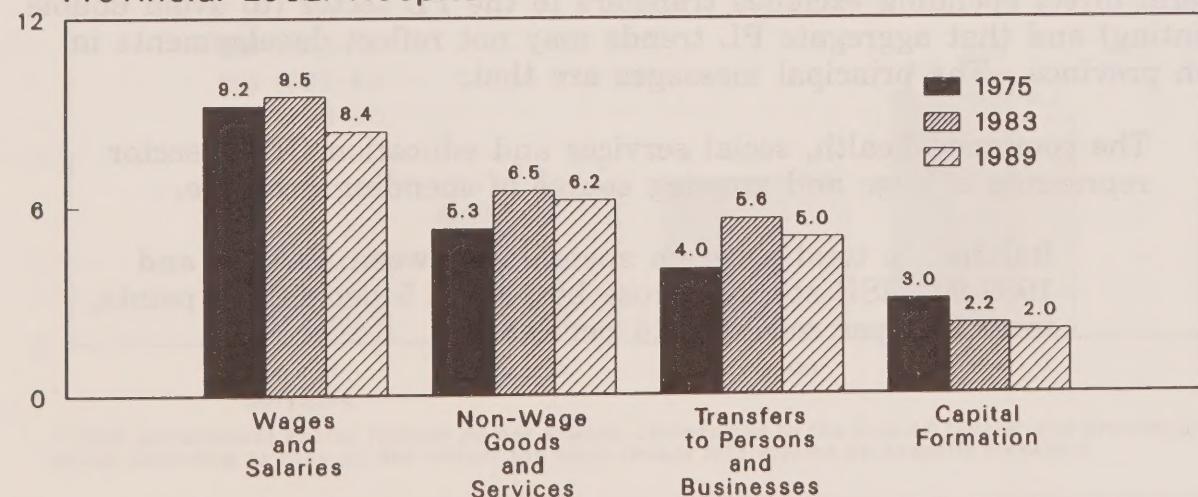


**Chart 2****The Structure of Direct Program Spending (National Accounts Basis)**

Per cent of GDP

**Total Government\***

\* Total may not add due to rounding. Excludes CPP and QPP.

**Federal****Provincial-Local-Hospital**

- However, debt charges increased continuously and more than doubled, from 3.8 per cent of GDP to 9.0 per cent.
  - This shift was very pronounced at the federal level, where debt charges shot up from 2.2 per cent of GDP to 5.8 per cent.
  - From a lower base, PLH debt charges almost doubled, from 1.7 per cent of GDP to 3.2 per cent.
- As a counterpart to the greater increase in debt charges at the federal level, the fall in direct program spending at the federal level accounted for all of the overall fall and PLH direct program spending was virtually unchanged.
- The overall reduction in program spending was accounted for primarily by falls in wage and salary payments (1.4 percentage points) and capital formation (1.3 percentage points) relative to GDP.
  - Falls relative to GDP in these areas at the PLH level were offset by increases in other spending categories, including transfers to persons and businesses.
  - However, falls relative to GDP were recorded in almost every category of federal spending.

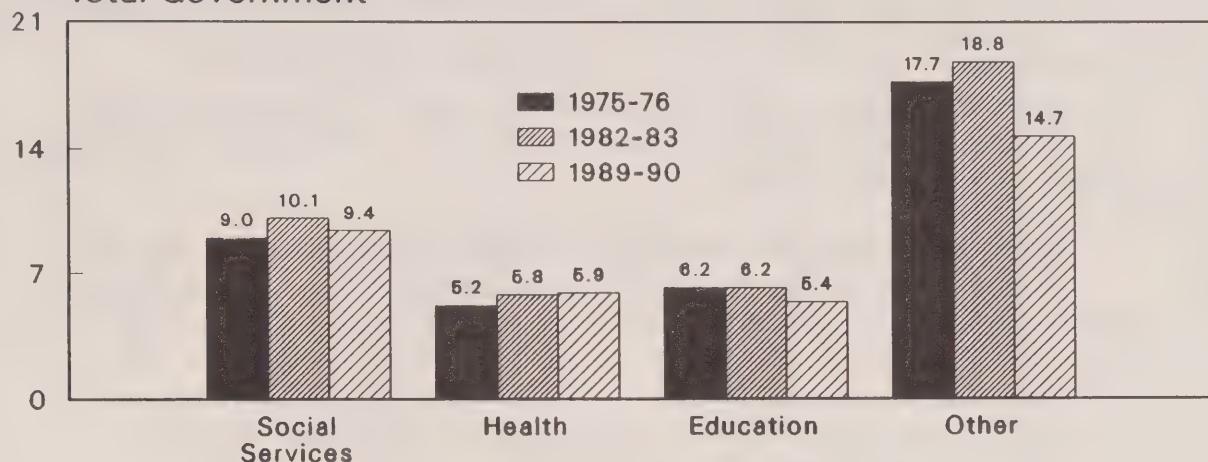
## **2.2 Program Structure of Spending between 1975-76 and 1989-90**

Chart 3 illustrates developments in the program structure of federal direct and provincial-local (PL) spending on a Financial Management System (FMS), financial-year basis. It should be noted that federal direct spending excludes transfers to the PL sector (to avoid double counting) and that aggregate PL trends may not reflect developments in each province. The principal messages are that:

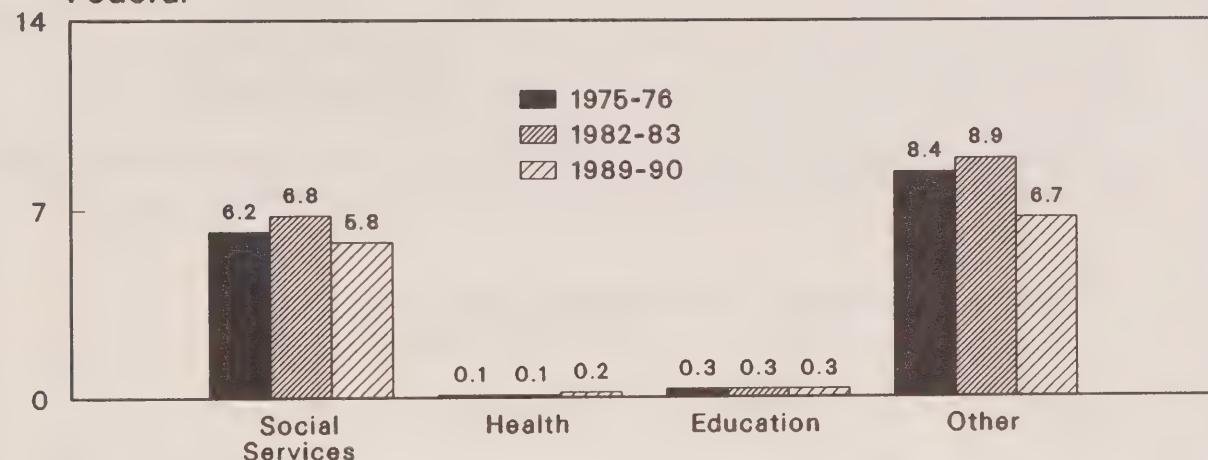
- The combined health, social services and education (HSE) sector represents a large and growing source of spending pressure.
  - Relative to total program spending between 1975-76 and 1989-90, HSE spending rose by almost 5 percentage points, from 53.7 per cent to 58.4 per cent.

**Chart 3**  
**The Structure of Direct Program Spending\***  
 FMS Basis -- per cent of GDP

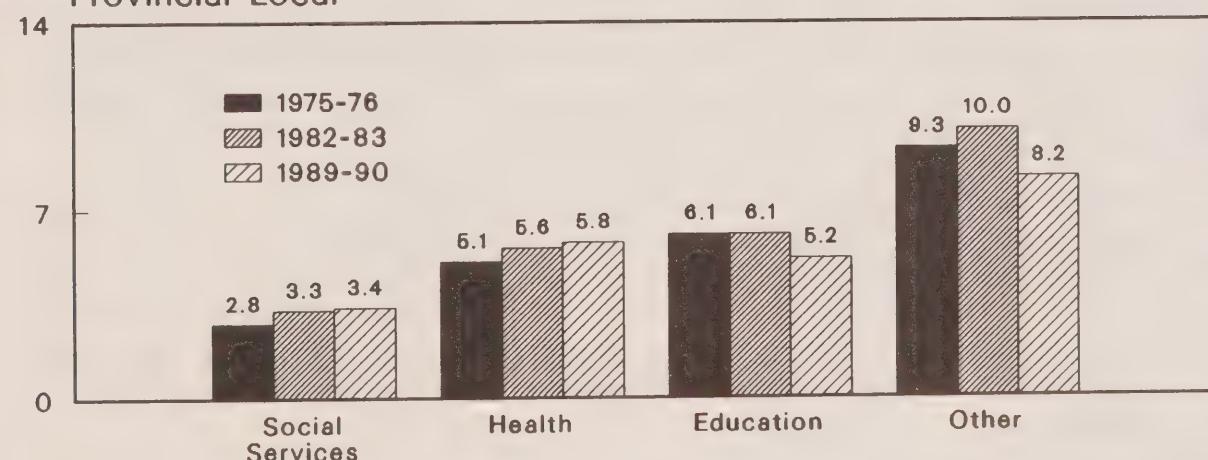
Total Government



Federal



Provincial-Local



\* Total government sector figures do not exactly correspond to the sum of federal and provincial-local direct spending as they do not reflect the most recent information on specific transfers.

- Relative to GDP (which grew somewhat faster than total program spending) between 1975-76 and 1989-90, HSE spending rose more modestly, from 20.4 per cent to 20.7 per cent.
- The slight increase in the GDP share of total HSE spending was attributable entirely to the PL sector, since the GDP share declined slightly at the federal level.
  - More than two thirds of HSE spending took place in the PL sector through the late 1970s and 1980s, where it consistently accounted for more than 60 per cent of program spending.
  - The much smaller amount of HSE spending by the federal government nevertheless consumed a substantial share of federal direct program spending throughout, at around 45 per cent.
- The slight increase in the GDP share of total HSE spending was concentrated entirely on medical and social services spending.
  - Medical spending increased from 1.4 to 1.9 per cent of GDP and social services spending increased from 9.0 to 9.4 per cent of GDP.
  - Hospital spending remained virtually unchanged, at 3.5 per cent of GDP, and education spending fell from 6.2 to 5.4 per cent of GDP.

### **2.3 Principal Cost Drivers**

The study explains the trends in government spending identified above as a mixture of economic, demographic, program-specific and policy factors. Most factors identified resulted in an increase in the GDP share of spending, for example:

- Growth in debt charges occurred principally because of a succession of large government deficits, particularly at the federal level and particularly since 1981.
- Growth in health care spending primarily reflected growing per capita demand for medical services. Factors underpinning this increase include:

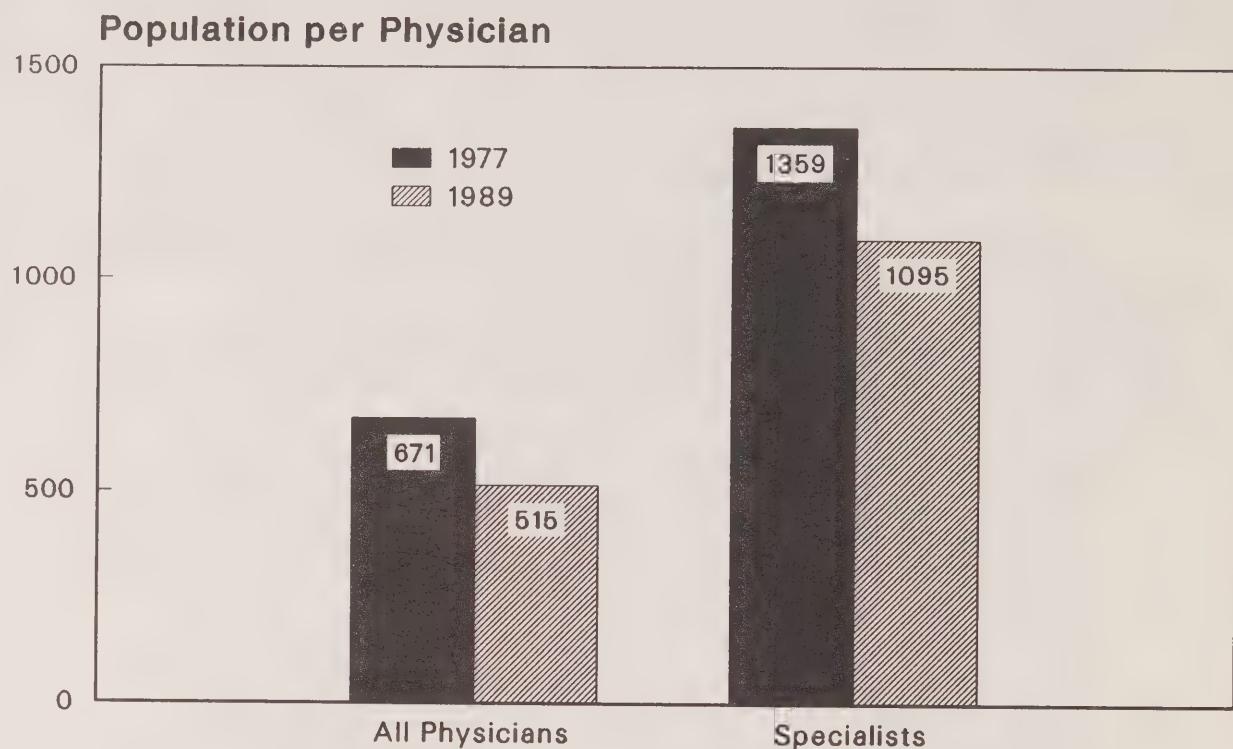
- Faster growth in physician and specialist numbers than in the total population.
- New medical technologies, which added new treatments.
- The aging of the Canadian population.
- Growth in numbers of services per physician, within a system that pays physicians on a fee-for-service basis.
- Growth in social services spending primarily reflected an increase in the proportion of the population in receipt of social service benefits.
  - The aging of the population resulted in increased demand for the Old Age Pension and related benefits at the federal level (although a fall in pensions relative to other incomes masked the impact of growth in recipients on the GDP share of pension payments).
  - The persistence of high unemployment rates following the 1981-1982 recession resulted in increased demand for unemployment insurance benefits at the federal level and general assistance benefits at the PL level.
  - A broadening of the coverage of workers' compensation programs at the PL level.

Some factors resulted in a reduction in the GDP share of spending, for example:

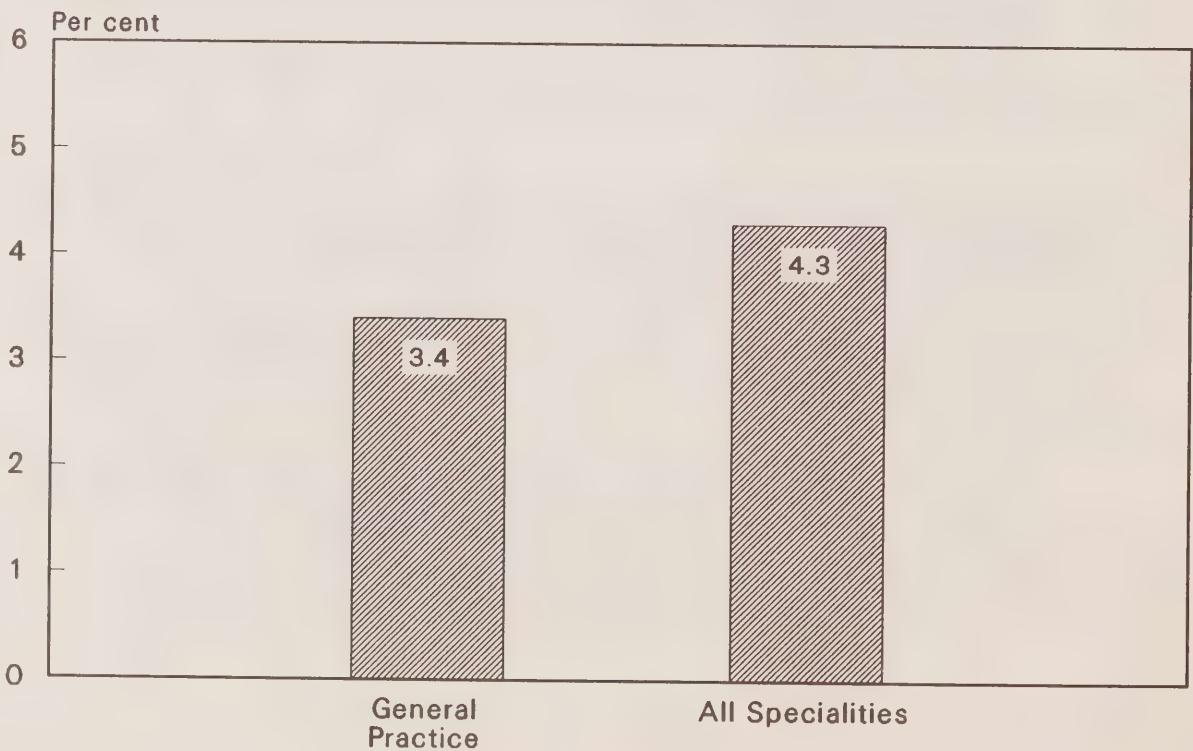
- Some governments developed fiscal management systems around the mid-1980s to contain costs; the effectiveness of these is evident in a number of areas, such as operating costs (including wages).
- The overall decline in the GDP share of education spending reflected a decline in the proportion of the population in the 5-24 year age group.

Charts 4 and 5 illustrate developments in some of the key cost drivers in the HSE sector between 1975-76 and 1989-90.

## Chart 4 Accounting for Growth in Health Spending



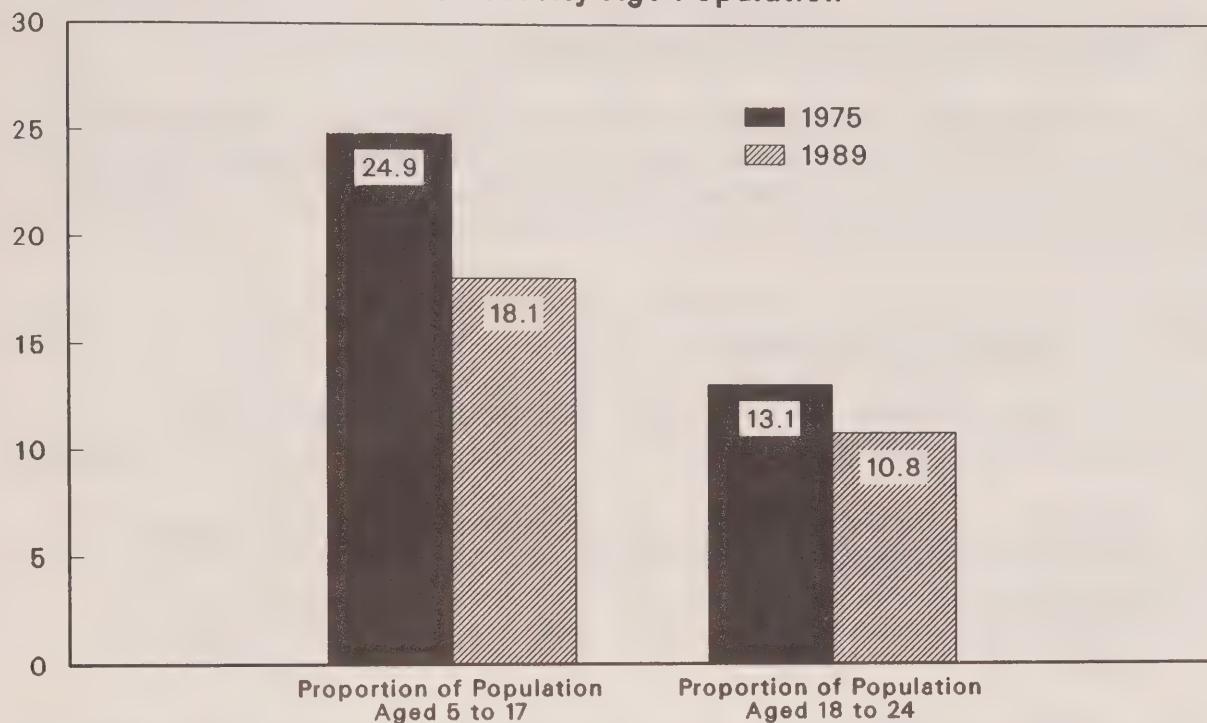
### Average Annual Growth in Number of Services for Medical Care Insurance : 1983-84 to 1987-88



### Chart 5

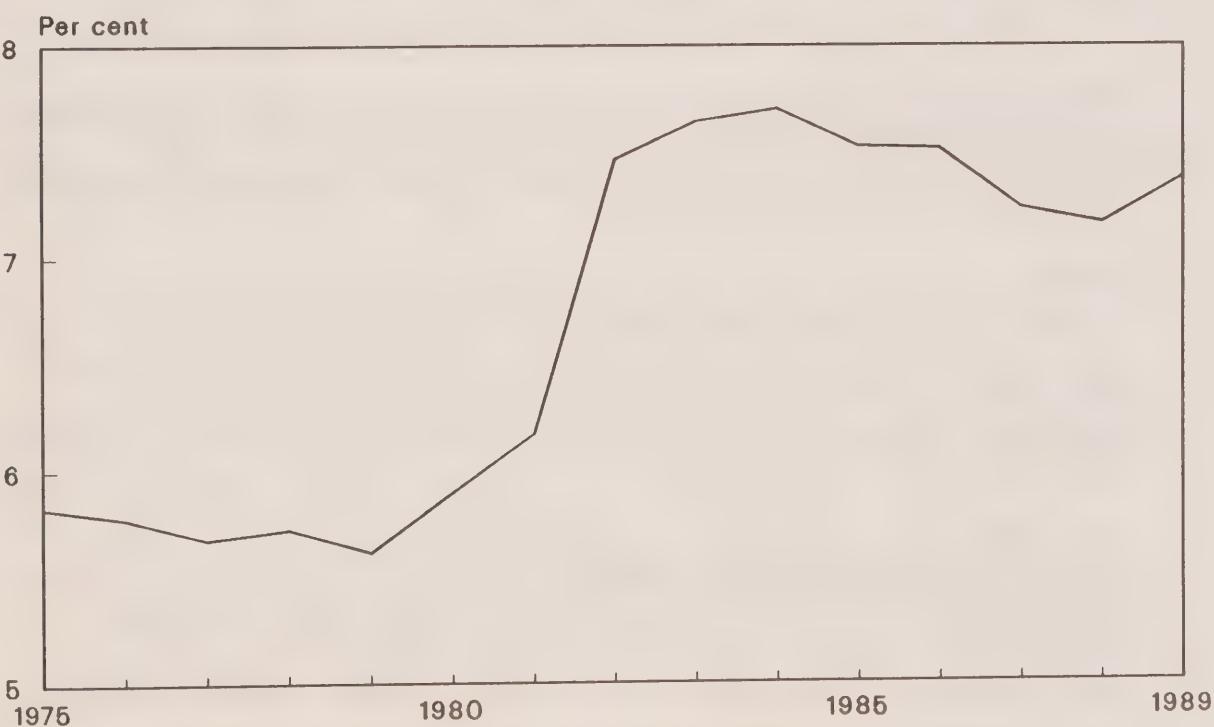
### Accounting for Growth in Education and Social Services Spending

#### Education: School and University Age Population



#### Social Services

#### Number of General Assistance Beneficiaries/Population: 1975-1989



### **3.0 Pressures on Government Spending in the 1990s and Beyond**

#### **3.1 Discussion of Principal Cost Pressures**

This section of the study presents a qualitative discussion on likely cost pressures in the 1990s and beyond. It identifies general cost pressures having an impact on several areas of spending and specific cost pressures having an impact on HSE and other spending.

##### **3.1.1 General Pressures**

Some factors will lead to lower spending indirectly by motivating governments to cut costs and increase efficiency. These include:

- **Pressure to be competitive in an increasingly integrated international economic environment.** This will mean that taxation systems and public sector demands on resources more onerous than international 'norms' will become more difficult to sustain.
- **Increasing public concern with the overall level of taxation.** This will affect the political trade-off between increasing taxation and reducing spending as a means of addressing the public debt problem.

Other factors will lead directly to lower spending, including:

- **Falling inflation pressures in Canada.** The combination of widely expected reductions in international and domestic inflationary pressures will help lower the growth of nominal spending in several areas, especially indexed programs.
- **Falling nominal interest rate pressures in Canada.** Lower rates of inflation will bring about lower nominal interest rates, which will ease the nominal cost of servicing debt. (Heavy borrowing by the former Soviet Union and Eastern Europe, combined with continuing large fiscal deficits in the USA, would impede a significant decline in world-wide real interest rates).
- **Strengthening economic growth in Canada.** The impact of structural reforms in most industrialised countries during the 1980s, combined with a cyclical rebound from the 1990-1991 recession, should lead to higher employment growth, reduced unemployment and, therefore, less pressure on a number of social services programs.

(However, the expected persistence of high unemployment rates through the early 1990s may delay some of the fiscal benefits.)

Factors leading to higher spending include:

- **Pressure to be internationally competitive.** As noted above, this will lead overall to downward pressures on taxation and spending. However, it will produce upward spending pressures in some areas, including:
  - Demands for better public infrastructure, which has aged and deteriorated following cutbacks since the mid-1970s. At both levels of government, the ratio of gross investment to GDP would need to increase by about 25 per cent just to maintain current capital stock to GDP ratios, let alone provide for a return to historical levels.
  - Demands for more flexible labour markets. Governments will be pressured to enhance labour market adjustment programs and fund increased demands on the school and university system.
- **High levels of immigration intended through the 1990s.** This will put pressure on immigration-related spending programs in the short term. (Immigration is generally thought to result in lower spending relative to GDP over the medium term because it brings about higher economic growth.)

Some of these pressures will affect revenues as well as spending. For example, lower inflation and lower nominal interest rates will affect revenue collections. The overall impact of these pressures on fiscal deficits is beyond the scope of the study.

### **3.1.2 Specific Pressures on HSE Spending**

As noted above, HSE spending accounts for over half of total program spending (higher than this at the PL level) and has been taking up an increasing share of program spending since the mid-1970s. Three types of pressure are distinguished:

- Pressure which arises from **changes in demand for existing programs.** Two separate influences on demand may be identified:

- Influences reflecting autonomous **demographic developments**, including population growth and changes in the age structure of the population. For example:
  - The relative aging of the population will continue to increase, as a proportion of the population, the demand for hospital and medical services, eligibility for Old Age Security and aged care facilities.
  - The relative fall in the school and university-age population will reduce, as a proportion of the population, school and university enrolments.
- Influences reflecting **socio-economic developments** independent of demographic developments. For example:
  - Increases are expected in numbers of single mothers, young offenders and child abuse cases. This will increase the demand for programs in these areas.
  - High levels of unemployment in the aftermath of economic restructuring and the 1990-1991 recession will put pressure on Unemployment Insurance, CAP programs and labour market adjustment programs.
- Pressure which arises from **changes in unit costs of existing programs** (cost per recipient or per unit of service). For example:
  - The unit cost of medical and hospital services will likely be raised by the proliferation of high cost high technology treatments, the need to compete with US remuneration and continued rapid increases in the cost of drugs.
- Pressures to **expand the coverage** of programs. For example:
  - In the social services area, there is pressure to extend workers' compensation benefits to cover stress-related diseases, to improve child care infrastructure and to address concerns of aborigines.

The study's qualitative assessment of the relative contributions of these factors to future costs through the 1990s is that demographic developments will not exert as much pressure as other developments. Indeed, demographic developments should contribute to lower costs in the

education area. These relative contributions to future costs are examined further via a series of mechanical extrapolations in Section 3.2.

### **3.1.3 Other Specific Pressures**

Other spending pressures highlighted by the study include:

- Pressure to make up the shortfall in unfunded government employee pension liabilities.
- Pressure to address concerns about a number of environmental issues, including acid rain and pollution in the Great Lakes.
- Pressure on the justice system related to:
  - An expected increase in criminality, which will affect the costs of the court system, of penitentiaries and of policing.
  - An expected increase in Charter of Rights challenges.

## **3.2 Mechanical Extrapolations of the Cost of HSE Programs**

The study supplements the qualitative examination of spending pressures summarised above by extrapolating the cost pressures facing governments in the HSE program area in the 1990s and out to the year 2025. An extended time period was used because the major demographic changes of interest in this study are typically slow to unfold. Naturally, any extrapolation of cost pressures so far into the future must be interpreted with caution.

The methodology underpinning this analysis involves:

- A standard set of assumptions about major economic and demographic parameters.
- A series of four mechanical extrapolations, each involving a progressive stepping-up of non-demographic cost pressures on HSE programs.
  - The purpose of this was to illustrate potential pressures on government spending arising from socio-economic developments and unit cost escalation.

- Sensitivity tests, involving shocks to key economic assumptions, to illustrate the influence of economic parameters on government spending.

### **3.2.1 The Economic and Demographic Assumptions**

The main economic and demographic assumptions used in the extrapolations are:

- The outlook from 1992 to 1996 is based on Federal Department of Finance projections. Thereafter, a consistent set of assumptions is adopted with respect to the main economic variables.
- The population growth rate slows down throughout the extrapolation period and the proportion aged over 65 years progressively increases, in line with Statistics Canada's demographic Scenario 3, modified to reflect recent policy announcements on immigration.
  - The fertility rate is assumed to be 1.67 per cent, immigration is assumed to average 250,000 per annum between 1992 and 1995, and remain a constant proportion of the population thereafter.
- Labour productivity and real wages grow at a fixed rate of 1 per cent per annum from 1995.
- Together, these assumptions lead to progressive declines in the employment and output growth rates.
- The inflation rate stabilises at the Federal Government and Bank of Canada's 1995 target of 2 per cent throughout the remainder of the extrapolation period.

### **3.2.2 The Four Extrapolations**

The four extrapolations were built up by increasing progressively the real per capita growth rates of the cost components of HSE programs. Since almost all federal programs are regulated by statutory formulae, real per capita costs are assumed to remain unchanged in the federal sphere. Hence, the increases in real per capita cost growth were confined to the PL sector.

The assumptions underpinning each extrapolation are as follows:

- **Extrapolation 1** assumes real per capita growth in all cost components is phased-down to zero by 2005 and maintained at zero thereafter.
- **Extrapolation 2** assumes real per capita growth in all non-wage cost components is in line with historical experience, while wage-related costs grow in line with Extrapolation 1.
- **Extrapolation 3** assumes real per capita growth in wage-related costs is stepped-up to the growth in productivity, with physicians and other health professionals receiving 1 per cent on top of this.
- **Extrapolation 4** assumes real per capita growth in all cost components is in line with historical experience.

Table 1 provides more detail on these assumptions for each cost component. Chart 6 illustrates the growth of total HSE spending in the PL sector under the four extrapolations (as noted above, federal spending is assumed to be the same under all extrapolations) and Chart 7 shows the extrapolations for each of the three categories of HSE spending in the PL sector.

In the following summary of the results, only Extrapolations 1 and 4 are considered in any detail. The main points to note regarding Extrapolation 1 are:

- Total HSE spending falls from the 1990 base of 20 per cent of GDP to 16.6 per cent through the extrapolation period, with PL spending falling from 14.7 per cent to 12.2 per cent. A reduction in PL education spending from 5.3 per cent of GDP to 3.2 per cent accounts for most of the overall reduction.
- Because growth in real per capita costs is phased-down to zero by 2005, this trend is explained almost entirely by demographic factors. Governments might take some comfort from this result, since it suggests that demographic factors alone will not apply significant upward pressure to the GDP share of government spending over the extrapolation period.
- There is a marked contrast between the assumption in the extrapolation period that real per capita cost growth is phased-down to zero by 2005 and experience since the mid-1970s of substantial growth, particularly in the health sector.

**Table 1**  
**Assumptions Underlying Extrapolations of PL HSE Spending**

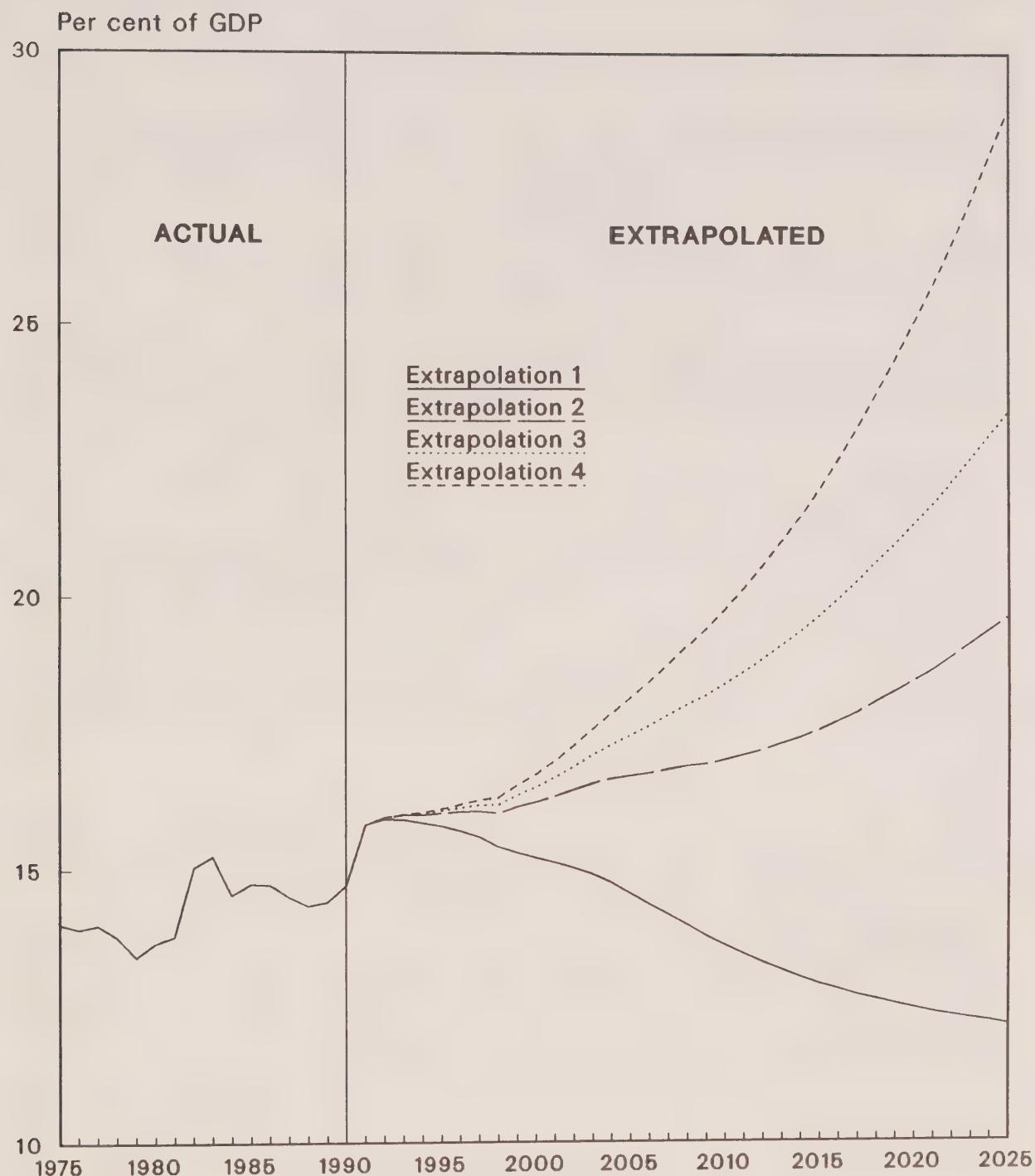
Cost Component	Average Growth of Real Per Capita Spending (per cent per annum)					
	<u>76-77 to 88-89</u>	<u>84-85 to 88-89</u>	<u>Ext.1</u> <sup>1</sup>	<u>Ext.2</u>	<u>Ext.3</u>	<u>Ext.4</u>
<b>Hospitals</b>						
• Wages & Benefits	2.6	1.2	2.0→0	2.0→0 <sup>1</sup>	prod <sup>2</sup>	2.0
• Med. & Surg. Supplies	6.7	11.6	7.0→0	7.0	7.0	7.0
• Drugs	6.8	15.3	7.0→0	7.0	7.0	7.0
• Other	3.9	-0.4	2.0→0	2.0	2.0	2.0
	<u>77-87</u>	<u>82-87</u>				
<b>Medical Care</b>						
• Physicians	5.1	6.5	5.0→0	5.0→0 <sup>1</sup>	prod <sup>2+1</sup>	5.0
• Other Professionals	6.7	2.2	6.5→0	6.5→0	prod <sup>2+1</sup>	6.5
• Drugs	11.7	11.6	10.0→0	10.0	10.0	10.0
	<u>76-77 to 86-87</u>	<u>81-82 to 86-87</u>				
<b>Elementary &amp; Secondary Education</b>						
• Teachers' Salaries	1.0	1.5	1.0→0	1.0→0 <sup>1</sup>	prod <sup>2</sup>	1.0
• Capital Spending	-0.1	2.3	3.0→0	3.0	3.0	3.0
• Other Op Spending	1.7	1.3	1.5→0	1.5	1.5	1.5
<b>Postsecondary Education</b>						
• Wages & Salaries	1.9	1.8	2.0→0	2.0→0 <sup>1</sup>	prod <sup>2</sup>	2.0
• Capital Spending	3.1	3.1	3.0→0	3.0	3.0	3.0
• Scholarships, etc	4.0	8.0	7.0→0	7.0	7.0	7.0
	<u>75-76 to 89-90</u>	<u>84-85 to 89-90</u>				
<b>Social Services</b>	3.7	2.9	3.0→0	3.0	3.0	3.0

1. Real per capita growth phased-down to zero by 2005.

2. Rate of growth of labour productivity.

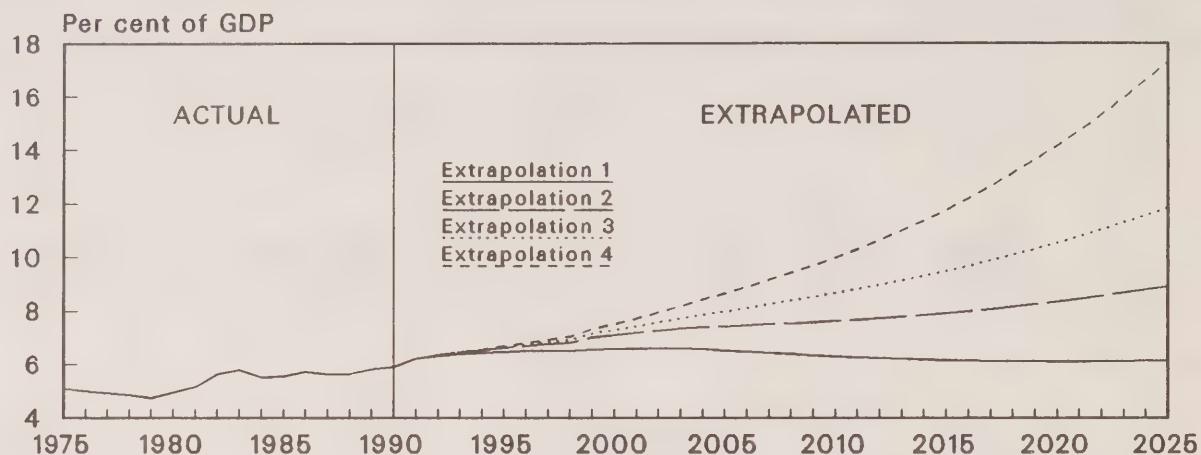
Sources: FMS, Statistics Canada, Health and Welfare Canada.

## Chart 6 Extrapolations of HSE Spending, P-L Sector

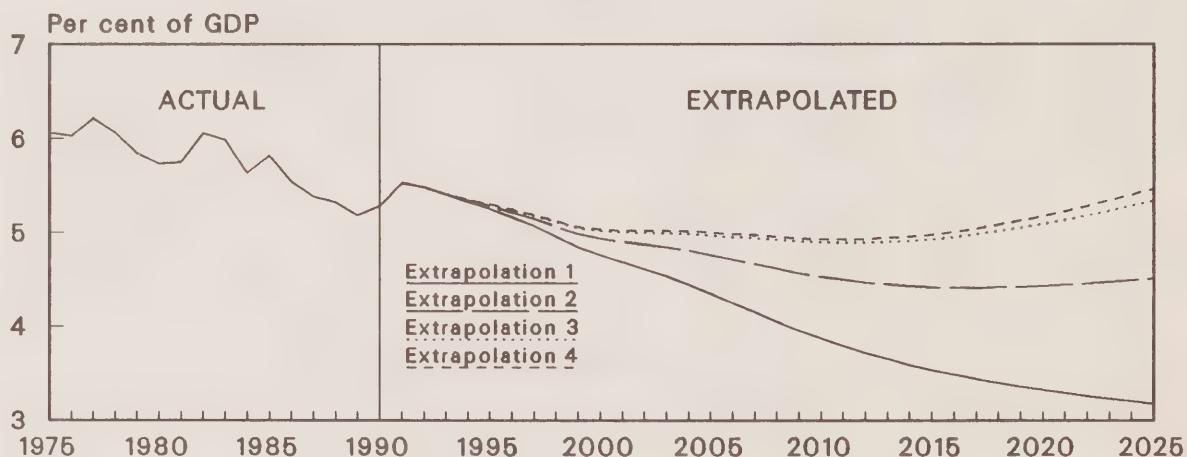


## Chart 7 Extrapolations of HSE Spending, P-L Sector

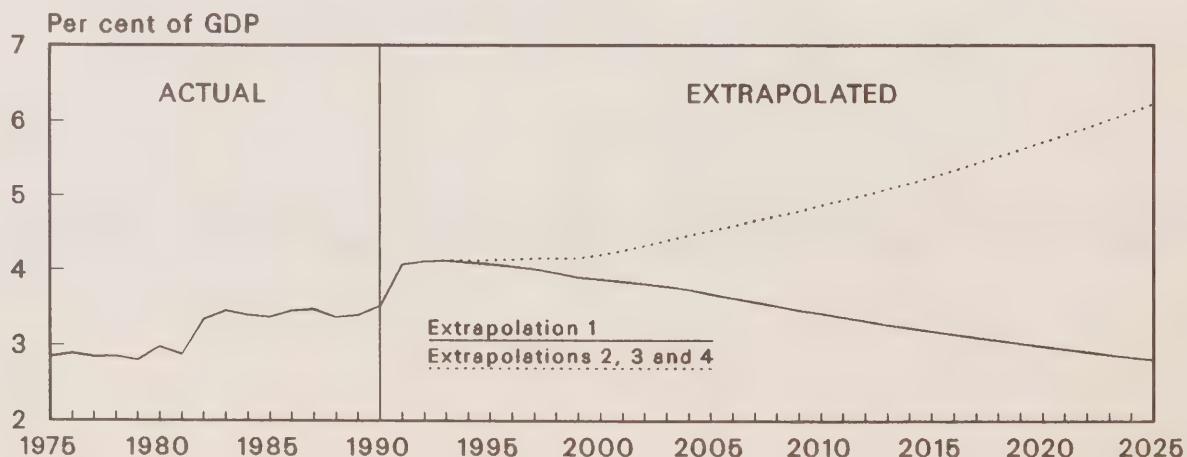
### Health



### Education



### Social Services



- Clearly, governments would need to make considerable changes to recent policy directions to achieve this outcome. (This is even more evident under Extrapolation 4 below.)

Important points regarding Extrapolation 4 are:

- Total HSE spending increases from the 1990 base of 20 per cent of GDP to 33.4 per cent by the end of the extrapolation period, more than double the Extrapolation 1 level.
- Given the assumption regarding federal HSE per capita cost growth (i.e., unchanged real level throughout), all of this higher spending takes place at the PL level.
- The clear message is that governments will be in very great fiscal difficulty in the foreseeable future if they allow past trends in health and social services cost growth to continue.

In all extrapolations:

- Most of the spending pressure occurs in the last half of the extrapolation period (ie, post 2005).
- Spending pressures are greatest in the health sector.
- Spending pressures decline or, at worst, stabilize, in the education sector.

### **3.2.3 The Sensitivity Tests**

Extrapolations which do not include any variation in the set of underlying economic assumptions cannot illustrate the extent to which broad economic variables might influence future trends in government spending. Yet general economic factors, particularly real growth, inflation and interest rates can have a marked impact.

To illustrate the potential importance of economic variables in the future, the study includes the following sensitivity tests:

- Shocks of sustained 1 percentage point increases in wages and interest rates, each from a 1990 base.

- The tests only allow for the direct effects of the wage shock on the public sector wages bill and the interest rate shock on debt charges.
- By year 3, the combined impact of these shocks raises government spending by around 0.9 per cent of GDP.
- Chart 8 illustrates the impact of these shocks on the spending of both levels of government.
- An increase in annual productivity growth from the assumed 1 per cent to 1.5 per cent.
  - Assuming government spending is unchanged by this increase, ratios of HSE spending to GDP would be roughly 16 per cent lower by the end of the extrapolation period.
    - For example, the GDP share of HSE spending by 2025 in Extrapolation 4 would have been 28.1 per cent instead of 33.4 per cent.
  - Such an improvement would be insufficient to overcome the concern about sustainability raised by Extrapolation 4.

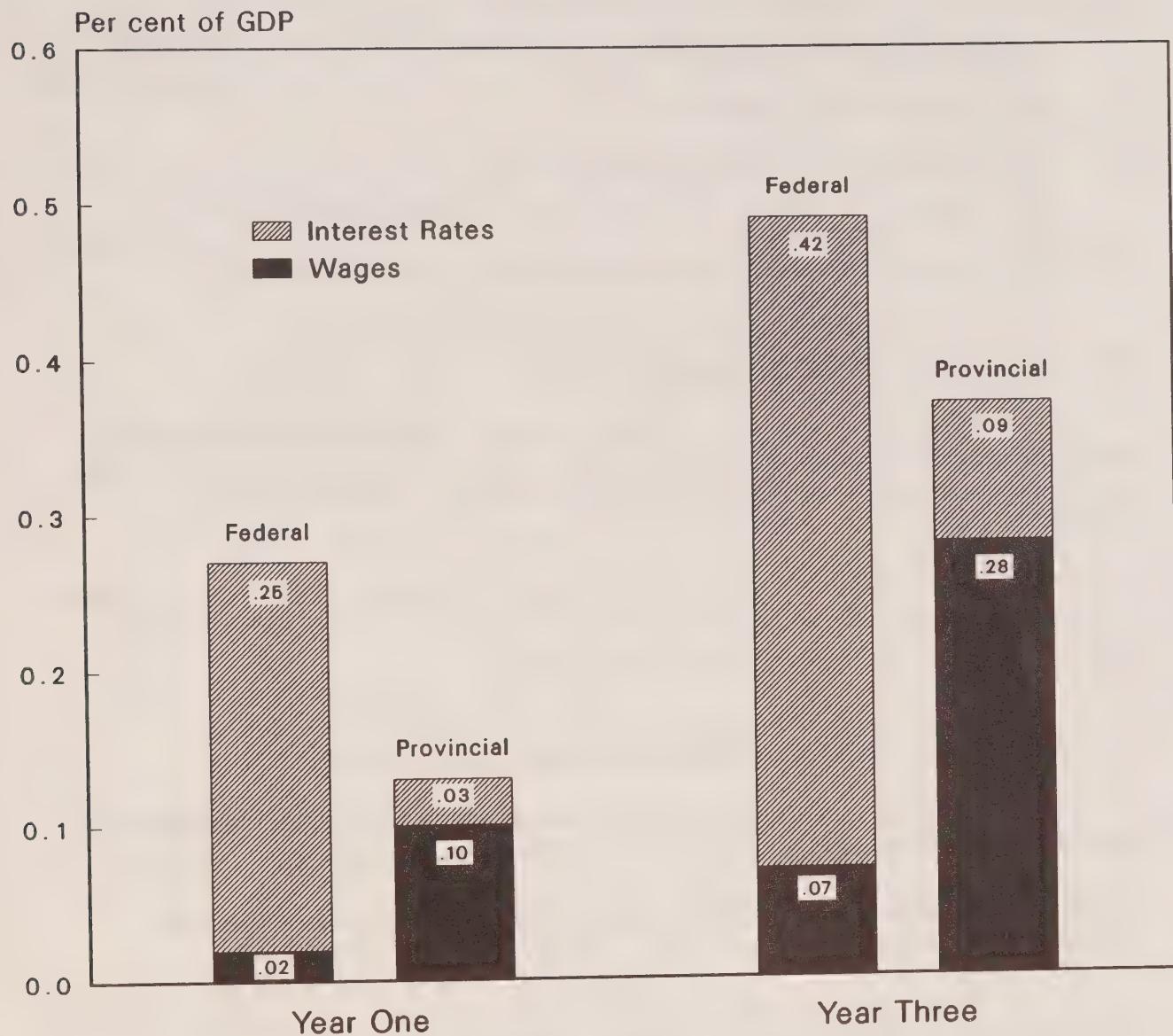
Clearly, departures from the economic assumptions above could have a major impact on the extrapolation results. That said, it is evident from this sensitivity analysis that the concern about sustainability is not merely a result of the particular assumptions chosen.

### **3.3 Conclusion**

Major conclusions drawn from this analysis of future cost pressures are:

- The increasing pressure to be internationally competitive will make it difficult to sustain policy arrangements which place the domestic economy on a 'tilted playing field'. Governments will come under pressure to ensure their taxation policies do not discriminate against domestic economic activity and that public sector activities are managed efficiently.
- The positive international and domestic outlook for inflation and growth in the 1990s is 'good news' which may help mitigate other spending pressures.

**Chart 8**  
**Sensitivity Analysis**  
**One Percentage Point Increase in Wage Growth and**  
**All Interest Rates**



- Demographic developments, such as the relative aging of Canada's population that will occur over the next 30 years or so, may not put as much pressure on future costs as is often expected.
- However, a continuation of past real per capita growth rates of costs in the HSE area would lead to a ballooning of spending pressures within the next generation and governments would be confronted with very difficult fiscal decisions.
- Past cutbacks in capital spending have resulted in an aging and a deterioration in public infrastructure. To the extent that this impedes improvements in competitiveness and efficiency, governments will be under pressure to increase their capital spending.

#### **4.0 Fiscal Restraint Strategies**

The study examined fiscal restraint strategies and individual fiscal measures adopted by governments, inside and outside Canada. The examination includes a case study of five selected OECD countries confronted with fiscal imbalances in the early 1980s.

The results of this examination are presented here in two parts: a thematic review of major fiscal restraint strategies adopted in Canada and a report on the international experience.

#### **4.1 Thematic Review of Major Strategies in Canada**

The study identifies a number of major strategies developed by various governments to address fiscal imbalances, including:

- The development of a fiscal management framework, with such features as:
  - Firm medium-term objectives for key fiscal parameters, such as total spending and budget balance.
  - Decision making machinery (such as special committees of ministers) which aims for a broad consensus among ministers on overall goals and particular measures; this forces all departments of government, particularly spending departments, to cooperate with the government's fiscal objectives rather than work against them.

- The introduction of measures believed to reduce operating costs and increase the efficiency of service delivery, such as:
  - Restructuring (and sometimes reducing the number) of departments of government to achieve economies of scale and/or more streamlined operating units, so as to reduce costs.
  - The promulgation of a new management ethos within government, which devolves greater authority over resources to individual agencies and managers to achieve results within specified budget limits.
  - Measures to restrain the growth of public sector wages. (Wages are the largest single component of operating costs at the provincial level.) For example, some jurisdictions have established bodies to develop remuneration standards for all public employees (from cabinet ministers down) and make recommendations to governments.
  - Putting various government activities on a more commercial footing, on the premise that this would provide more effective discipline on costs. For example, imposing user charges for services and contracting out services provided by the private sector.
  - The outer limit of this has been to privatise entire 'commercial' public enterprises, where the market-place was thought to provide more effective discipline on costs.
- Generally, there has been less emphasis on specific measures to reduce program costs by cutting or curtailing programs, however:
  - In the education area, demographic factors have led to reduced enrolments in recent years. Consequently, some rationalization of human resources took place.
  - In the health area, cost control measures include global caps on billing by physicians and tighter control on hospital budgets.

#### **4.2 Summary of International Experience**

The study examined general trends in OECD countries, and conducted a more detailed analysis of five countries whose experience was felt to be of particular interest to Canada, to see what could be learned

about future cost pressures and spending control options from an international perspective. The five countries were the United States, the United Kingdom, Germany, Australia and New Zealand.

Major cost drivers in the early 1980s in the five countries singled out for detailed review have a familiar ring:

- Program enrichment and extension in the social services area.
- Government consumption spending, particularly wage costs.
- Debt charges.
- The impact of increases in the old-age dependency ratio on health care costs in countries with public health care systems.

Major cost control measures introduced included:

- Medium-term targets for deficit and spending reduction.
  - This approach has been used successfully in Germany and Australia.
  - Deficit target legislation was not effective in the US and real spending caps, allowing for higher than expected inflation, have recently been introduced.
- Measures to enhance the efficiency of the economy in general and the public sector in particular.
  - The United Kingdom and New Zealand sought to increase efficiency by privatising several commercially-oriented government agencies.
- Increased targeting of eligible recipients of program benefits.
  - This approach was used extensively in the United Kingdom, Germany, Australia and New Zealand.

### **4.3 Conclusions and Lessons for Canada**

The main messages from the study's review of approaches taken by governments inside and outside Canada to restraining spending are:

- The development of an overall fiscal management strategy, involving the setting of medium-term fiscal objectives and the establishment of appropriate decision making machinery is a key to success.
- Governments have sought to achieve savings by taking measures intended to increase the efficiency of service delivery. Measures taken include restructuring departmental functions, greater devolution of management responsibility and greater reliance on market-place cost disciplines such as user charges and privatisation of commercial public sector enterprises.
- Social security and other income maintenance programs have put the greatest upward pressure on spending in several jurisdictions. These pressures have often been reduced substantially by more rigorous targeting of eligible recipients.
- Not surprisingly, the international survey did not bring to light any 'painless' method of reducing spending previously unknown in Canada.

### **5.0 Summary of the Key Messages**

While the study was broad ranging, covering an examination of past and future cost pressures on both levels of government and examining options to deal with these pressures drawn from experience in Canada and on the international scene, it can be distilled into a fairly small number of important messages. These are:

- The major developments in government spending since the mid-1970s, expressed as a proportion of GDP, were:
  - A sharp escalation in debt charges, a legacy of large deficits in the early 1980s, particularly at the federal level but importantly at the PLH level as well.
  - A reduction in program spending, again at the federal level and especially since the mid-1980s.
- The principal components of the reduction in program spending were wages and salaries and capital spending.

- Spending in the HSE area has dominated program spending to an increasing degree since the mid-1970s, particularly at the PL level, reflecting:
  - The development of new medical treatments, based on new technologies, faster growth in physician numbers than in the total population and escalating drug costs.
  - The persistence of high unemployment following the 1981-1982 recession, which increased the demand for unemployment insurance benefits and for general assistance benefits.
  - The aging of the Canadian population, which increased the demand for medical services and for social service benefits.
- Major factors likely to influence costs in the 1990s and beyond are:
  - Pressure to become more competitive, arising from the increasing globalization of national economies. This will lead to pressure to set taxes at competitive levels and to ensure public sector activities are managed efficiently.
    - Competitiveness pressure may also lead to pressure to spend more to refurbish public infrastructure and to enhance labour market adjustment programs.
  - The positive international outlook for inflation and growth. This will lead to downward pressure on spending.
  - Pressure to maintain past rates of increase in real costs of HSE programs. This will lead to very strong upward pressure on spending.
- An examination of the recent experience of governments inside and outside Canada indicates the following approach has been widely used to address spending pressures:
  - The development of an overall fiscal management strategy, involving the announcement and/or legislation of medium-term fiscal goals and the establishment of appropriate decision making machinery.
  - A concentration of restraint measures on operating and capital budgets.

- The introduction of measures intended to reduce operating costs by increasing the efficiency of service delivery, ranging from restructuring of government activities, to the introduction of user charges, to privatizing commercial public enterprises.





